Part III: The Kentucky Agricultural Finance Corporation

Background

The Kentucky Agricultural Finance Corporation (KAFC) was created by statute in 1984 but facilitated its last farm purchase in 1991 before entering a period of dormancy. The Linked Deposit Program was created in 1996, and the KAFC was authorized to administer the agricultural component. In 2002, the ADB considered KAFC as an option to provide access to capital for agricultural diversification and infrastructure projects as part of the *Long-term Plan for Agricultural Development*. In order to carry this out, the ADB awarded KAFC $20 million in 2003 from the funds provided by the Master Settlement Agreement (MSA) but under the administration of the Kentucky Department of Agriculture (KDA).

KRS 247.940-247.978 detailed the original intent and operations of the KAFC under the KDA. During the 2004 General Assembly, Senate Bill 146 amended KRS 247.940-247.978 to restructure and move the administration of the KAFC to the GOAP from the KDA. The ADB subsequently awarded KAFC an additional $3 million in 2006 and another $3 million in 2007.

The KAFC is governed by a twelve member board. Ten members are appointed in staggered four year terms by the Governor. These ten board members may include two officers from a commercial lending institution, an officer from a farm credit association, an agricultural economist and must include a tobacco farmer, a cash grain farmer, a livestock farmer, a dairy farmer, a horticulture farmer, and someone from the equine industry. The Governor must also appoint a member of the ADB who meets the qualifications and takes the place of one of the aforementioned positions. The other two members include the Commissioner of the Department of Agriculture, who shall serve as chairperson, and the Secretary of the Finance and Administration Cabinet. The Executive Director of the ADB also serves as Executive Director of the KAFC Board. KAFC Board members approve all projects, except in the Agricultural Infrastructure Loan Program (AILP) where loans under $50,000 having a certain credit score may be approved by the staff loan review committee.

When GOAP began administering KAFC in 2004, the main staff person in charge of the corporation was the Marketing and Business Development Coordinator. Today, the KAFC has three main staff members. The Director of Financial Services manages loan portfolios and marketing, communicates with lenders, and assists with financial analysis for both ADB and KAFC applications. The Financial Records Specialist receives the applications and completes an initial review of applications for completeness and eligibility under the guidelines. A Special Projects Coordinator assists with internal data management and processes for KAFC, as well as process repayments. Additional GOAP staff assistance is provided to KAFC, as needed, including General Counsel, Director of Communications, the Fiscal Officer, and the Senior Policy Analyst.

When the KAFC was originally created in 1984, the primary intent was to make funds available to young farmers wanting to purchase farmland. Today, the KAFC has four primary loan programs funded by the ADF. These programs include the Agricultural Infrastructure Loan Program and Beginning Farmer Loan Program (BFLP), which are indirect loan programs, and the Agricultural Processing Loan Program (APLP) and Coordinated Value-Added Assistance Program (CVALP), which are direct loan programs. Indirect loans must be originated and serviced by participating lenders. Direct loans can be made between KAFC and the recipient without an outside lender involved. To date, KAFC has approved 249 projects and committed over $26 million. Of the 249 total projects, one is a CVALP, six are APLP loans, 43 are Beginning Farmer loans, and 199 are AILP loans. All four programs are designed to provide access to below market financing for individuals or companies in Kentucky related to agriculture in order to enhance farming operations and profitability. The loans are distributed in a manner that will allow these funds to be preserved and continued to be utilized in the future.

The **Agricultural Infrastructure Loan Program** allows KAFC to offer loans to individual producers making capital expenditures for long-term agricultural projects involving capital improvements. Financing can be used for acquisition, renovation, and construction of on-farm agricultural structures. In order to be eligible for an AILP loan, applicants must receive at least 20% of his or her gross income from farming. Loan recipients with documented history of tobacco dependency can receive a fixed interest rate of 2% APR. Individuals who cannot document tobacco history receive a 4% interest rate. The term of the loan cannot exceed 15 years or the useful life of the asset being financed. KAFC will allow a loan up to $250,000 not to exceed 50% of the project cost. Loans can be used for dairy, swine, beef, equine, poultry, grain, vegetable, or tobacco facilities; equipment storage; fencing; aquaculture structures; or other long-term structures at the discretion of the KAFC Board. Loans cannot be used for operating expenses or to refinance existing debt.

The **Beginning Farmer Loan Program** allows the KAFC to assist individuals with farming experience who desire to develop, expand or buy into a farming operation. Beginning farmers can use the loan to finance or purchase livestock, equipment, agriculture facilities, secure working capital, make a down payment on real estate, or invest in a partnership or LLC. In order to be eligible for a BFLP loan, applicants must have at least three years of experience in operating a farm, must substantially participate in these farm operations, and have not operated a farm for more than ten years. Applicant (and spouse, if applicable) must have a combined net worth of less than $500,000 and commitment from a mentor to offer advice in their farming endeavors. All BFLP loans receive a fixed interest rate of 2% APR for up to 15 years. KAFC will loan up to $250,000 for new investments.

The **Agricultural Processing Loan Program** can be utilized by companies and individuals interested in agricultural processing that add value to Kentucky grown agricultural commodities. Loans are available to entities pursuing capital expansion, construction, or renovation. Term length is not to exceed 20 years. KAFC has a statutory loan limit of $1,000,000 per loan;

however, budgetary language increases this limit to $5 million through June 30, 2010. Interest rate is determined on a per loan basis.

The **Coordinated Value-Added Assistance Program** provides loans to companies and individuals who create contract production opportunities for other agricultural producers. Funding can be used to renovate or expand existing facilities, acquire equipment or obtain permanent working capital to facilitate an expansion. KAFC will finance loans of up to $1,000,000 with a limit of $100,000 for each new grower opportunity created. Term length is not to exceed 5 years. Interest rate is determined on a per loan basis. Applicant can finance no more than 25% of their project through this program.

The **Linked Deposit Investment Program**, which originates from Kentuckys Unclaimed and Abandoned Property Account, provides funds to Kentucky banks for low-interest loans to Kentucky farmers. This program was not included in the evaluation since the funds do not originate from the ADB.

Summary of KAFC Loan Programs:

Agricultural Infrastructure Loan Program

- History of tobacco production to receive 2% interest rate
- 20% or more of income from farming for the last 2 years
- $250,000 maximum amount and 50% or less of total project
- 15 year term limit

Beginning Farmer Loan Program

- Not operated a farm for more than 10 years
- Minimum of 3 years participation in business operation of a farm
- Combined net worth of less than $500,000
- Applicant off-farm income of less than $75,000 and $100,000 for household
- $250,000 maximum amount, 15 years or less
- 2% fixed interest rate

Agricultural Processing Loan Program

- Construction, renovation / expansion of processing facilities
- Must add value to Kentucky agricultural commodities
- $5,000,000 maximum
- 20 year term limit
- Interest rate to be determined

Coordinated Value-added Assistance Loan Program

- Business expansion that will provide contract opportunities for KY farmers

- Facilities, equipment or working capital
- 5 year term limit
- $1,000,000 maximum
- $100,000 or less per grower opportunity created
- 25% of project or less
- Interest rate to be determined

In the spring of 2008, KAFC changed the maximum participation from $100,000 to $250,000 and the maximum term from 10 to 15 years for the AILP and the BFLP.

Evaluation Criteria for KAFC

The 2007 Annual Report for the KAFC makes clear that the Board supports the priorities of the ADB:

> "Marketing and Market Development has been considered the top priority for the Kentucky Agricultural Development Fund. The KAFC Board also shares this vision of adding value to Kentucky grown agricultural commodities by providing below market financing to projects accomplishing these goals." (Annual Report July 2006–June 2007, pg. 34)

However, the 2006–2007 Annual Report also restates that Priority #2 of the ADB, directly addressing financing and capital availability:

> "Improving Access to Capital The Kentucky Agricultural Development Board recognizes that, while capital sources are generally available to producers, commercial lenders might be reluctant to provide financing for products and businesses where there is limited financial history. To address this concern, the Board supported the reactivation of the Kentucky Agricultural Finance Corporation." (pg. 6)

Therefore, the evaluation criteria for the KAFC loan programs should be similar to the criteria used to evaluate the Non-Model investments, as expressed in the ADB investment philosophy: increasing net farm income, affecting tobacco farmers and tobacco-impacted communities, and market development (i.e., stimulating new markets, adding value to Kentucky products, and exploring new opportunities for Kentucky farms and farm products). In addition, the ADB seems to have intended the funds flowing to KAFC to provide capital to businesses with limited financial history.

Data Collection

In order to evaluate the effectiveness of KAFC loan programs, the UK Evaluation Team asked for a list of all loans for each program. From this list, the Evaluation Team was able to select a representative sample of loans to review based on the type of loans, the purpose of the loan, and the geographic location of the applicants. Twenty loans were selected which represent a sample of approximately 10% of the 218 loans made, as of May 2008.

A UK student intern was assigned to work in the KAFC office in Frankfort to assemble background files for each of the loans to be evaluated. Typically the file consisted of KAFC documents including the loan application, a loan application summary sheet, a narrative describing the applicants experience in farming, and the loan request (usually written by the participating lender), correspondence from the participating lender, a certificate of participation between KAFC and the local lender, and a loan closing verification form. Tax forms included in the KAFC files were not photocopied nor collected by the UK Team.

Survey Questionnaire

The survey questionnaire developed for the Non-Model Projects interviews was adapted for use with the KAFC loan evaluation. Using the same basic framework for the questionnaire, modifications were made to identify the specifics of the KAFC loans made, the activities funded by the loans, and an estimate of the resulting impacts from the loan. A separate version of the survey form was developed for borrowers and lenders in order to capture their respective points-of-view. All of the borrowers from the twenty sample loans were interviewed, as well as seven participating lenders. Most of the lenders had experience with multiple KAFC loans. A copy of the borrower and the lender interview survey forms is attached in Appendix A.

Site Visits and Interviews

The UK Evaluation Team traveled to the project site for each loan included in the KAFC sample in order to see first-hand the results of the loan and personally interview the applicant. The map below shows the locations of the site visits and interviews for the KAFC loan sample.

Survey Briefs and Impact Data Collection

Each site visit and loan interview was summarized into a one page survey brief in order to give a concise view or “snapshot” of the purpose of the loan, the loan conditions, and an evaluation of the loans potential impact. The KAFC loan survey briefs for the twenty loans sampled are attached in Appendix B.

Survey Questionnaire Results

The results from face-to-face interviews with the KAFC borrowers and lenders were tabulated and are presented in the following tables (with the survey question preceding each table). In general, several general conclusions can be drawn from the survey results:

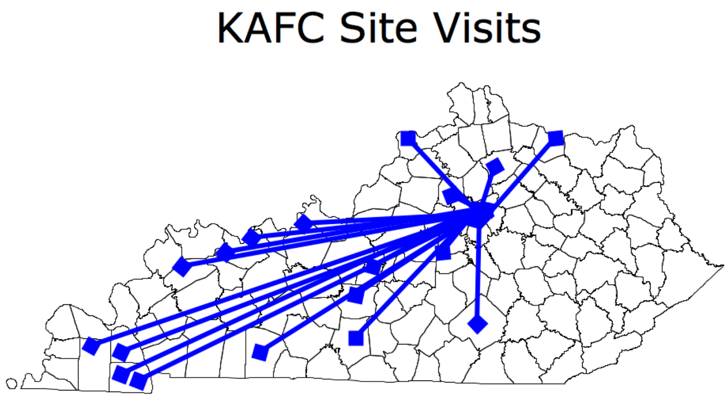

Figure 11: *KAFC site visits.*

A. The borrowers and lenders overwhelmingly agree (89%) that the ADF is a good use of the Master Settlement Agreement funds and that the ADB use of funds has been consistent with their investment philosophy: *"The Kentucky Agricultural Development Board will invest monies from the Kentucky Agricultural Development Fund in innovative proposals that increase net farm income and effect tobacco farmers, tobacco-impacted communities, and agriculture across the state through stimulating markets for Kentucky agricultural products, finding new ways to add value to Kentucky agricultural products, and exploring new opportunities for Kentucky farms and farm products."*

Table 45: *Responses to: "Based on my experience, the Ag Development Boards use of funds is consistent with the Board investment philosophy."*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Strongly Agree	50%	50%	50%
Agree	35%	50%	39%
Disagree	10%	0%	7%
Strongly Disagree	5%	0%	4%
N/A	0%	0%	0%
Total	100%	100%	100%

B. Unlike the situation in the Non-Model Investments evaluation, all of the loan projects visited by the UK Team were completed and in use. This is likely a consequence of the loan processing requirements of the private lenders which resulted in more monitoring of borrowers than is the case with the Non-Model investments. In addition, 80% of borrowers and 100% of lenders indicated that the borrower received enough KAFC money to successfully complete the project. In the Non-Model evaluation, 85% of all recipients indicated they received enough ADB money to complete their project.

Table 46: *Responses to: "The ADF investments have benefited Kentucky."*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Strongly Agree	60%	88%	68%
Agree	40%	12%	32%
Disagree	0%	0%	0%
Strongly Disagree	0%	0%	0%
N/A	0%	0%	0%
Total	100%	100%	100%

Table 47: *Responses to: "The ADF investments have been an effective use of tobacco settlement (MSA) funds."*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Strongly Agree	65%	75%	68%
Agree	35%	25%	32%
Disagree	0%	0%	0%
Strongly Disagree	0%	0%	0%
N/A	0%	0%	0%
Total	100%	100%	100%

Table 48: *Responses to: "Have you (or has the borrower) accomplished the purpose of your (their) KAFC loan?*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Yes	100%	100%	100%
No	0%	0%	0%
Total	100%	100%	100%

C.Half of the borrowers in the sample have received some other form of ADF assistance. This was generally cost-sharing funds from the County Model Program or Non-Model grants or forgivable loans. However, there was no indication of any coordination between the KAFC lending and the other sources of ADF funding on any of the loans included in the sample.

Table 49: *Responses to: "We received enough KAFC money to successfully implement this project.*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Strongly Agree	30%	50%	36%
Agree	50%	50%	50%
Disagree	20%	0%	14%
Strongly Disagree	0%	0%	0%
N/A	0%	0%	0%
Total	100%	100%	100%

Table 50: *Responses to: "Have you applied for any ADF grant or loan funds?*

Response	Borrowers (N=20)
Yes	50%
No	50%
Total	100%

D. There was substantial leverage on all KAFC loans, primarily due to the loan terms and conditions. All the lenders interviewed either "strongly agreed" or "agreed" to the question about KAFC money helping borrowers leverage other funds for the project.

Table 51: *Responses to: "The KAFC money helped me (or the borrower) leverage other funds for this project."*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Strongly Agree	45%	50%	46%
Agree	45%	50%	46%
Disagree	10%	0%	8%
Strongly Disagree	0%	0%	0%
N/A	0%	0%	0%
Total	100%	100%	100%

E.Given the eligibility conditions for AILP loans which grant a lower interest rate to those with a history of tobacco production, it was not surprising that 75% of all KAFC borrowers said that their loan helped tobacco farmers, and 86% state that they have helped tobacco-impacted communities, as well.

Table 52: *Percent of yes responses to: "Has this project helped tobacco farmers, and tobacco impacted communities?"*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Tobacco farmers	70%	88%	75%
Tobacco impacted communities	80%	100%	86%

F.Most of the borrowers (86%) say their project will have a long term impact on their business. This is predictable since most of the loans involved structures, equipment, or land purchases.

Table 53: *Responses to : "How far into the future do you see the benefits of this project reaching."*

Response	Borrowers (N=20)	Lenders (N=10)	Total (N=30)
Short term	0%	0%	0%
Intermediate	15%	12%	14%
Long term	85%	88%	86%
N/A	0%	0%	0%
Total	100%	100%	100%

Analysis of Impacts of KAFC Loans

KAFC Program Awareness—Despite the educational efforts of the KAFC staff to publicize the availability and conditions for loan programs, about 75% of the borrowers were made aware of the KAFC loan alternatives through their lender or through direct contacts from KAFC staff. The remaining 25% of borrowers learned about KAFC through commodity associations, the media, or a family member/neighbor.

KAFC Loan Process—When asked about the KAFC loan process (i.e., interaction with staff, application, Board meetings, decision making) both the borrowers and lenders were generally very positive in their comments. The application process was viewed as open and "easy" by most borrowers. A very few borrowers, particularly in the BFLP, indicated the application process was difficult, "requiring too many hoops to jump through." During the interviews, Bill McCloskey was singled out for several positive comments, as well as other staff at KAFC.

Several lenders indicated a concern with the "slow" decision making process, where most loan applications need approval by the full Board. Since most lenders have weekly management meetings for loan processing decisions, the relatively infrequent KAFC Board meetings appear "slow" to lenders.

Loan Portfolio—The following table shows the amount of KAFC loans made in each of the four KAFC loan programs. As of May 2008, KAFC has made 218 loans for a total of $23.2 million dollars. The majority of loans (81%) have been made through AILP, which primarily has loaned money to build barns and grain bins. The next largest loan numbers were with the BFLP loans (17%) of which about half of the borrowers purchased land and the other half built barns, purchased equipment, or acquired livestock. Only four loans have been made through the APLP, however these were for large amounts which encumbered $9.2 million, or 40% of total KAFC loan funds. Only one loan has been made through the CVALP for a fairly large amount which encumbered 4% of the total KAFC loan funds.

Table 54: *Kentucky Agricultural Finance Corporation loan statistics as of May 2008.*

	Number of Loans	**Total Amount (millions)**	**Percent of Loans**	**Percent of Total KAFC Funds**	**Total Project Cost (millions)**	**KAFC Percent of Total Project Cost**
Ag Infrastructure Loans	177	$10.14	81%	44%	$31.24	32%
Beginning Farmer Loan Program	36	$2.89	17%	12%	$11.40	25%
Ag Processing Loans	4	$9.20	2%	40%	$31.76	29%
Coordinated Value-added Infrastrucure Loans	1	–	0%	4%	–	25%
KAFC Total	218	$23.19	100%	100%	$78.26	30%

There has been a substantial amount of leveraging for KAFC loan funds. Averaging over all four KAFC loan programs, KAFC has loaned 28% of the total project costs, a 3:1 leverage ratio.

Impacts by Loan Program—The estimated impacts of the four main KAFC loan programs, based on the loan file data for the representative sample of loans, information secured in the interviews, the site visits, and the Expert Group meeting, are summarized below:

(a) Agricultural Infrastructure Loan Program (AILP)—The AILP has had the most loan activity. All of the borrowers interviewed citied the lower interest rates as the primary reason they pursued a loan with KAFC. Many new tobacco barns have been built in Western Kentucky to allow increased tobacco production in that part of the state. Grain bins, dairy barns, poultry barns, hay storage and farm shops have been built with the loans, as well. The impacts of these investments would include both enterprise expansion and improved prices from the sales of quality products due to better storage or more timely marketing.

When borrowers were asked: "Would this loan have happened without the KAFC loan program?," 86% of the AILP borrowers replied in the affirmative. If this is the general situation

Table 55: *Kentucky Agricultural Finance Corporation Loans through May 2008.*

Barns	149	Processing	4
Grain bins	30	Farm Shop Bldgs	3
Farm Land	19	Livestock	3
Equipment	4	Operating Loans	1
Total Number of Loans	**218**		
Ag Infrastructure Loans	177	**Ag Processing Loans**	4
Tobacco	73	Timber	2
Grain	31	Bio-fuel	1
Dairy	18	Pharmaceuticals	1
Poultry	16		
Beef	10	**Coordinated Value-added Infrastrucure Loans**	1
Swine	9	Operating Funds	1
Equine	8		
Forage / Hay	5	**Beginning Farmer Loan Program**	36
Other	5	Land	19
Vegetable	2	Barns	10
		Farm Shop Building	4
		Livestock	3

with the AILP loans, then this is a point of troubling concern. If the project would have been completed without the KAFC financing, then the actual impact of the KAFC loan is limited to the reduced interest rate (interest subsidy). Some of the borrowers stated they would not have done the project as soon as they did or maybe not as large without the lower KAFC interest rates. This indicates that low-interest financing is encouraging technology adoption and expansion of production. However, if 86% of the AILP borrowers can obtain financing elsewhere, KAFC is essentially duplicating conventionally available agricultural credit.

The access to capital issue in ADB Priority #2, "financing for products and businesses where there is limited financial history," was examined by looking at the net worth of borrowers in the AILP. In the representative sample, the average net worth for AILP borrowers was $2.8 million (Table 56). One borrower with very high net worth ($12.4 million) skews the average upwards, so removing this borrower and recalculating results in average net worth of $1.7 million. This is considerably higher than the net worth of the average UK Kentucky Farm Business Management Program (KFBM) participants ($1.4m) and twice the estimated net worth of "family farms" in the U.S. ($900,000). KFBM farmers are considered some of the most progressive and better managers in the state due to their commitment to recordkeeping and on-going financial analysis. If the ADB passed funds to the KAFC "for products and businesses where there is limited financial history," then the AILP loan portfolio does not reflect pursuit of the original intention of the ADB for the KAFC funding.

(b) Beginning Farmer Loan Program—The KAFC completed 36 BFLP loans of May 2008 for a total of $2.9 million or 12% of the total loan funds. Five beginning farmers who received loans were interviewed, as well as several lenders who have had multiple experiences with the program.

Table 56: *Net worth comparison: KAFC vs KFBM vs US family farm average.*

Project Type, Description	KAFC Amount	Project Cost	Net Worth Listed on Application
Agricultural Infrastructure Loan Program			
Beef:Barn	$20,000	$37,666	$235,861
Dairy:Barn	$100,000	$758,249	$12,431,905
Equine:Renovations	$50,000	$113,841	$1,198,000
Forage:Barn	$21,500	$43,000	$1,112,241
Grain:Bin	$44,000	$88,000	$6,927,012
Other:Barn	$98,000	$149,427	$4,447,096
Poultry:Barns	$100,000	$353,800	$976,001
Swine:Barns	$100,000	$848,981	$463,886
Tobacco:Barn	$18,250	$36,500	$466,860
Tobacco:Barns	$61,377	$125,506	$828,076
Grain:Bin	$35,000	$59,176	$1,180,290
Average Net Worth per Loan			**$2,751,566**
Beginning Farmers Loan Program			
Dairy:Tractor	$12,597	$25,195	$132,889
Equine:Purchase Farm	$100,000	$254,300	$254,300
Grain:Farmland	$37,500	$150,000	$25,491
Horticulture:Equipment	$100,000	$200,000	$217,639
Diversified:Farmland	$100,000	$246,632	$37,900
Average Net Worth per Loan			**$133,644**
Agricultural Processing Loan Program			
Timber:Equipment	$550,000	$1,250,000	$4,108,068
Plants:Processing	$3,600,000	$8,400,000	$188,049
Timber:Processing	$53,000	$106,000	$2,314,900
Average Net Worth per Loan			**$2,203,672**
Since only one Coordinated Value-added Assistance loan was awarded, statistics are not reported for privacy reasons.			
Other Measures of Net Worth			
Average Net Worth per Farm Type [a]			
	All KY Farms		$1,337,098
	Grain		$1,515,202
	Hog		$892,000
	Dairy		$1,140,234
	Beef		$860,000
USDA ERS "Family Farm" Average Net Worth			
	"Family Farms"		$860,000

[a] 2007 KY Farm Business Management Program.

Any "beginning farmer" financing program addresses two serious issues in modern farming: high initial capital requirements and intergenerational transfer issues. The high costs for land and equipment acquisition by new farmers is a major barrier to entry for younger, thinly capitalized, entrepreneurs. The KAFC Beginning Farmer Loan Program directly addresses this issue by providing long-term, low-interest financing at start-up (i.e., borrowing the down payment for land purchase). In addition, there is often a substantial cost for intergenerational transfer of farm ownership from older family members to younger members. This is a critical issue in Kentucky since the average age of U.S. farm operators is over 55 years of age. A BFLP loan can directly assist in ownership transfer of farms to younger family members, thus keeping management and control within the family and contributing to community stability.

Four out of five borrowers and all of the lenders interviewed stated that the BFLP loans would not have happened without the KAFC participation. In the case of land purchases, beginning farmers were able to borrow the down payment funds from KAFC. This lowered the risk for the participating lender as KAFC would take a second position behind the participating lender on the mortgage. Without land ownership it is difficult for beginning farmers to have collateral for a land purchase. Lacking collateral, a large cash down payment would be required. All of the beginning farmers said it would have been difficult to come up with the down payment money without the KAFC loan.

Because the BFLP has requirements for maximum net worth ($500,000), maximum income ($100,000), and experience (<10 years), it would be expected that borrowers would have modest net worth. In the representative sample, the average net worth of the Beginning Farmer loans was $133,644. This is modest capitalization for a new agricultural entrepreneur and certainly in keeping with spirit of Priority #2 of the ADB.

The impacts on farm income from the BFLP are difficult to measure because these are mostly loans to purchase land; in which case, the future income would be a projection of anticipated results. However, it can be said that all of the BFLP loans have resulted in assisting a younger farmer to develop a new farm business in an industry with substantial barriers to entry. It is predicted that the largest turnover of assets in the history of this country will be taking place in the next two decades as the post-World War II generation inherits the older generations assets. With the average age of Kentuckys farmers at 55 years old, there is a need for younger people to continue operating farms and utilizing farm land and other fixed assets.

(c) Agricultural Processing Loan Program —There were four APLP loans made as of May 2008. Two of the loans were for wood processing firms, one was for plant-based pharmaceutical production, and one was for new bio-diesel fuel processing.

The APLP financing accounts for only 2% (4 of 218) all KAFC loans. However, these loans are large, relative to the AILP and BFLP, and account for 40% of the total KAFC portfolio. Thus, three of the four loans were included in the representative sample of APLP loans included in this evaluation. (The fourth APLP loans was the bio-diesel plant which was previously interviewed in the Non-Model Project evaluation.)

The average net worth for the APLP borrowers was $2.2 million. Since these are existing processing firms, the amount of net worth should be considered in light of the goal of working with firms having "limited financial history." However, in all four cases the APLP borrowers stated they could have borrowed the money elsewhere. The plant-based pharmaceutical manufacturer indicated they had a very short time line to act on their purchase of an existing facility under bankruptcy proceeding. The assistance of the KAFC staff was instrumental to their being able to act quickly to acquire the property. Like the other three borrowers, they could have borrowed the funds elsewhere. However they believe the control of the company probably would have gone to an out-of-state firm.

All of the businesses are adding value to Kentucky agriculture products. In addition, the four APLP borrowers have added twenty-eight full-time employees as a result of their expanded operations. However, actual impacts are difficult to assess because these projects could have been financed elsewhere, and two of the projects were still under construction or not yet in full production at the time of the site visits. At some point in time, impacts of these four projects (setting aside concern about alternative financing) could be estimated in terms of additional income generated by multiplying the total annual revenue from the new operations times the percentage of financing provided by the KAFC. In the case of Dickerson Lumber, there is potential for additional income generated and job creation. However, at the time of the interview, the owner-operator said the current market situation in lumber made it impossible to say net income had increased.

It seems clear that the APLP loans have the potential to contribute positively to the ADB goals of adding value to Kentucky products, exploring new opportunities for farm products, adding jobs, and affecting tobacco-impacted communities. However, it is not possible to make conclusive statements at this point.

(d) Coordinated Value-added Assistance Loan Program—The CVALP provides loans to companies and individuals who create contract production opportunities for other agricultural producers.

KAFC has completed only one CVALP at the time of the evaluation. This is a fairly large loan made in conjunction with a participating lender. The purpose of the loan is operating capital. The current loan is providing contract opportunities for other farms who are working with the borrowers. Therefore the purposes of the loan are being met and it appears consistent with the overall goals of ADB and KAFC. Due to privacy requirements, details of the sole CVALP loan and impacts cannot be discussed here.

The purpose of this loan program is not unlike the forgivable loan concept used by the ADB to insure there is a larger impact on the agriculture community beyond the applicants individual project. In the case of forgivable loans the applicant has their loan gradually forgiven based on the amount of Kentucky agricultural products they purchase from others. In the case of CVALP loans, the borrower must be involved with coordinating (contracting) other farms to join in the value chain they are creating and is required to pay back the loan in five years or less. Although the programs have a similar purpose, the level of risk reduction is vastly different. A 100% forgivable loan is essentially a grant to the successful borrower, where as a CVALP loan is not. If risk reduction to encourage new coordinated ventures is the goal, the CVALP is not offering a lot of incentive. In addition, the stipulation that the CVALP can only fund 25% of a project severely limits the ability of KAFC to mitigate risks to encourage new ventures.

KAFC Expert Meeting

The UK Evaluation Team attempted to validate evaluation findings by convening a varied group of professionals who have direct knowledge the programs and or their impacts. The "Expert Meeting" for the KAFC portion of the evaluation included nine people, some of whom are KAFC participants (borrowers or lenders) and others who have a background in agricultural finance or related farm-oriented activities. Details on the Expert Meetings are contained in Appendix C.

From the discussion in the Expert Meeting, it seems apparent that most of the participants became aware of the KFDC loan programs either from presentations given by the staff from the GOAP at professional meetings or from board meetings of the ADB. Participants generally agreed with survey findings that farmers are learning about the programs from bankers and other agricultural lenders. Most participants agreed that it is typical that agricultural lenders approach the farmer about potential KAFC loans opportunities and not the other way around.

There was a discussion about each of the KAFC loan programs. Comments about the AILP loans generally pointed out that this program is the easiest to apply for and that the guidelines are straight forward and simple to underwrite. The lower, "blended" interest rates are a major incentive and have encouraged some people to borrow the money sooner or to build a little bigger barn. The experts did not argue with the contention that the benefits of a KAFC loan, which the borrower could have financed elsewhere, are essentially confined to the interest subsidy.

The BFLP was discussed as being very helpful in Kentucky, particularly in reducing the lender risks for this type of loan. The lenders present agreed that most, if not all, of these loans would not have happened without the KAFC participation. There was a general consensus that loaning beginning farmers their down payment money helps "make the loan" and provides some collateral for the participating lender. Concerns were expressed about the BFLP eligibility requirements. It was suggested that KAFC follow the same guidelines as the Farm Service Agency for defining "beginning farmer." The current KAFC requirement that borrowers have at least three but less than 10 years farming experience makes ineligible the children of existing farmers who have been a part of the family operation for 10 or more years. Another suggestion was for KAFC to consider offering a "first time land purchase" program in place of the existing BFLP.

None of the participants had experience with the APLP loans or the CVALP loans.

Members of the Expert Group did offer some suggestions for new loan or financing options which the KAFC Board should consider:

- Offer operating or equipment loans for livestock operations. If KAFC is going to play a larger role in central and eastern Kentucky, then it must have loan products which directly apply to full and part-time livestock producers.
- Make the participation loan (50% of total loan) a "guaranteed" loan, backed by the KAFC. More lenders would participate if there was a loan guarantee feature. This would allow banks to market part of the loan on the secondary market and generate fee income.
- The 15-year amortization on Beginning Farmer loans is good but KAFC should consider a 20-year amortization on larger Beginning Farmer loans.
- Coordinate the GOAP grants for projects with KAFC financing so that local banks serve as partners, not competitors with the GOAP programs. It is unfair for government-sponsored enterprises to compete with for-profit local businesses.

There were additional comments made by participants in the Expert Group regarding the KAFC program:

- The KAFC loan process is easy and understandable, but they should streamline the process for loans under $50,000. Allow lenders to qualify the borrowers for loans of $50K or less, which would make it more attractive for them to make $10 $30K loans.

- Is it really necessary for the KAFC Board to meet personally with applicants? Consider a standing loan review committee which includes staff and Board members. This new loan review process should be more timely and must be beyond reproach.
- The lower "blended" interest rates are a major incentive and have encouraged some people to borrow the money sooner or to build a bigger barn. A 2-3 percentage point reduction in interest rates on a loan is not going to be the determining factor in farming operation sustainability.
- KAFC loans are mainly going to traditional agriculture businesses. What about more loans for new ventures and value-added enterprises?
- Why is the money invested in KAFC helping only 218 farmers? Is that an effective use of state funds?
- Is it risk reduction or diversification to use ADB funds to build tobacco barns?
- KAFC is not as effective as the Model and Non-Model programs because there is little risk abatement on activities designed to encourage agricultural diversification. KAFC financing should be focused on taking some of the risk out of starting new ventures.
- If one-third of the KAFC loans are not going belly up then KAFC is not reducing risk for diversified efforts and new ventures.
- KAFC has put the advertising burden on the lenders. KAFC needs to promote their programs to farmers, tell them what they have to offer.
- County Model programs are wildly successful, other programs such as the Non-Model project grants/loans and KAFC are not widely known. Its become blurred as to what is available and where ADF, KAFC, County Councils?

Conclusions and Recommendations

1. **The KAFC appears to be carefully administering the funds supplied by the Agricultural Development Board for improved capital financing in agriculture. Both borrowers and lenders are pleased with the administration of the program, the staff are considered helpful and knowledgeable, and there is good financial record-keeping, reflecting the collaboration with lenders having due diligence standards. In site visits and interviews, the Evaluation Team did not encounter any issues of concern about general program implementation.**

2. **The outreach educational efforts by KAFC staff seems to primarily focus on agricultural lenders but not farmers. The loan program options are not well-understood and recognized by the general farm population.**

   Recommendation: KAFC should pursue new educational efforts directed at farmers, commodity groups, farm organizations, and agribusinesses.

3. **The current loan portfolio is primarily distributed in western Kentucky counties, reflecting the popularity of the Agricultural Infrastructure Loan Program among tobacco and grain producers. If KAFC is going to expand loan implementation to more of a balanced state-wide distribution, then loan products will have to**

appeal to livestock producers, horticulture, agri-tourism, and agribusinesses in central, northeastern, and eastern counties.

> ***Recommendation: Focus outreach efforts towards regions where there is little current loan activity but potential for financing projects with marketing and market development potential (e.g., Agricultural Processing and Coordinated Value-Added loans).***

4. **The composition of the current loan portfolio appears to primarily emphasize low-risk financing of relatively high net worth borrowers. Except for the BFLP loans (17% of all loans), the majority of AILP and APLP borrowers have relatively high net worth and are "experienced" business entities, not new ventures. This raises the question of how effectively the current loan portfolio addresses the ADB goal of improved capital access to those with "limited financial history."**

> ***Recommendation: KAFC should have a clear mission statement that identifies program goals which further the stated mission of the Agricultural Development Fund and appropriately targets loan products to fulfill the mission.***

5. **The Agricultural Infrastructure Loan Program is the most popular KAFC loan program (81% of loans, 44% of value) primarily because it provides low blended interest rate, preferences for tobacco producers, a convenient and transparent application process, low risk to KAFC and agricultural lenders, and it is favored by producers of traditional major crops. However, the projects funded by the AILP do not appear to accomplish the market development objective or risk reduction for entities with limited financial history. While infrastructure loans have a positive impact on the efficiency and profitability of individual producers, the overall program benefit is limited to the interest subsidy because 86% of the borrowers would have completed the projects without KAFC participation. AILP may be duplicating loans that are already readily available from private lenders.**

> ***Recommendation: If the KAFC mission involves improved capital access to entities with "limited financial history," then the Board should consider redesigning the Agricultural Infrastructure Loan Program to better serve beginning farmers, new agricultural ventures, and agricultural diversification efforts.***

6. **The Beginning Farmer Loan Program directly addresses the issues of barriers to entry for new farmers and intergenerational transfer of farming operations, making it a key loan product. The current 36 BFLP loans (17% of total loans, 12% of value) appear to be appropriately targeted and are meeting the goal of improving capital access to those with limited financial history. The financial benefits are clear for borrowers and impacts should expand over time as participants continue in agriculture and more loans are implemented.**

Recommendation: The BFLP should be expanded so that it represents a larger share of the total portfolio and funds more new farmers.

Recommendation: Guidelines should be changed to accommodate people who have farmed but not owned a commercial size farming operation. Loans should be targeted at knowledgeable and committed applicants pursuing a commercial farming venture, so that the KAFC loan will "bootstrap" the applicant into a first-time commercial farming venture in which they have an ownership stake. (A commercial venture could be defined as capable of producing 50% or more of the net family income.) Loans should not be based on age or employment.

7. **The Agricultural Processing Loan Program is accomplishing the goal of marketing and market development. However, there are only four loans in this part of the portfolio and they represent 40% of loaned funds. All four borrowers stated they could have borrowed the money elsewhere but they liked the lower interest rates. It is questionable whether these loans are needed in the normal course of agricultural processing. The fourth APLP loan was made to an innovative plant-based pharmaceutical manufacturer. If successful this investment could result in a large amount of contract production for Kentucky farmers to raise specialty crops. Of the four APLP loans, perhaps this loan is the only one that could result in new markets and greater opportunities that would not have happened without the KAFC.**

    Recommendation: KAFC should revise loan program guidelines to target new and existing firms needing venture capital for the development of new, value-added Kentucky agricultural products.

8. **The Coordinated Value-added Assistance Loan Program seems intended to support value chains involving multiple farms producing and selling into specific large markets. This has the potential to directly address ADF Priority #1, marketing and market development. However, only one loan has been made in the CVLP, possibly because participation is limited to 25% of the total project. A 25% participation loan may not reduce the risk enough for participating lenders to fund new proposals about innovative value-added ventures in agriculture. Because Kentucky has so many small farms, this coordinated approach has high potential to help these producers access larger markets and gear production towards specialty, niche markets such as grass-fed beef, organic produce, or specialty grains.**

    Recommendation: Revise the program guidelines to expand risk reduction and encourage new and innovative ventures. Seek collaboration with projects in the ADB Non-Model Program to provide a combination of loan and grant financing that could provide enough risk reduction to launch new ventures and encourage private lenders to participate.

Recommendation: KAFC should seek collaborative financing of new Coordinated Value-added Loans with ADB providing additional risk reduction through grant funding of new ventures.